

Internal Revenue Service

District Director

MAR 09 1999

Department of the Treasury

P.O. Box 2508
Cincinnati, OH 45201

Person to Contact:

Telephone Number

Refer Reply to:

Date:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(7) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a trust or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely yours,

C. Ashley Bullard
C. Ashley Bullard
District Director

Enclosures: 3

Facts

Information submitted with your application indicates that you were incorporated [REDACTED]. Your Articles of Incorporation states that you were formed for the purpose of acquiring, developing, owning and operating golf and country club facilities for the social and recreational enjoyment of your member, their guests and others, within the meaning of Section 501(c)(7) of the Code.

[REDACTED] which is a for profit organization, is the organizer and the developer of the Applicant's facilities which includes an eighteen hole golf course, putting and chipping greens, driving range, clubhouse with dining and banquet facilities, pro shop, an outdoor swimming pool and tennis courts, and health club facilities. The golf course opened in the summer of [REDACTED] and the club house and recreational facilities were due to open in the summer of [REDACTED].

The application indicates the Applicant will enter into a management contract with [REDACTED] to manage the Applicant's facilities. However, the management contract between [REDACTED] and the organization show that it was entered into on [REDACTED] which is a year and a half before the application for exemption was submitted. The Applicant will pay the manager an amount equal to [REDACTED]% of the Applicant's gross revenue. The manager will maintain and operate all aspects of the Applicant's facilities. This includes maintenance and repair of all the equipment, grounds, plants, parking areas and building, and management of the pro shop, golf course, restaurant and banquet facilities.

The application also states the Applicant will enter into a Land Lease Agreement with [REDACTED] which is an affiliate of [REDACTED] to lease the land on which the Applicant's facilities is located. However, the lease agreement between [REDACTED] and the organization show that it was entered into on [REDACTED]. The basic rent for the use and occupancy of the leased premises is \$[REDACTED] for each lease year, adjusted each year to reflect the average percentage increase in the Consumer Price Index.

The Applicant will purchase all of the rights and interest of the [REDACTED] in the Applicant's facilities for [REDACTED] cost, estimated to be \$[REDACTED] million. The [REDACTED] is the parent company of [REDACTED] and [REDACTED].

The Applicant has authorized [REDACTED] shares of nonvoting preferred stock, divided into two classes, Class A and Class B. The Class A preferred stock and Class B preferred stock will be offered only to certain persons qualified for membership. On payment of the Initiation Fee, a member will receive a share of nonvoting preferred stock as follows: a Full Member will receive one share of nonvoting Class A preferred stock and a Corporate Member will receive one share of nonvoting Class B preferred stock. Holders of Preferred Stock have no voting rights except to the limited extent provide by the By-laws.

[REDACTED]
[REDACTED]

Presently, the Initiation Fee for a Full Membership ranges from \$[REDACTED] to \$[REDACTED] for the first five blocks of membership. The Initiation Fee for each Corporate designee of a corporate membership is expected to be [REDACTED]% of the then-current Initiation Fee for a full member. The Applicant currently expects to offer a total of [REDACTED] Full Memberships and [REDACTED] Corporate Memberships. Article IV of the articles of incorporation indicate that the number of shares of stock that the corporation is authorized to issue is [REDACTED] shares consisting of [REDACTED] shares of non-voting Preferred Stock, no par value, and [REDACTED] shares of common stock, no par value. The club is not open to the general public. They must also pay a monthly dues which is established by the Board of Directors.

The applicant has issued and outstanding [REDACTED] shares of common stock, no par value, all of which is issued to [REDACTED] in exchange for \$[REDACTED] per share. No dividends are allowed per article 3.3.1 of such Articles of Incorporation. Common stock may only be issued to [REDACTED] or its affiliates. Each share of Common Stock entitles the holder to one vote.

The By-laws states the directors will be elected by the shareholder entitled to vote at each annual meeting and not the preferred stock members per article 11.2 of the by-laws. Vacancies may be filled by the remaining directors, or by the shareholder entitled to vote. The business and the affairs of the corporation will be managed by a board of directors. The number of directors will be as set by the Articles of Incorporation or by resolution of the Board of Directors from time to time. If not set by the board or the Articles, the number of directors will be three(11.1). The initial board members are:

Name	Address
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]

The officers of the corporation will include a President, Secretary, and Treasurer and one or more Vice-Presidents, as the Board of Directors may determine.

The Board of Directors establishes the one time initiation fee, the monthly dues amount, and can approve increases up to [REDACTED]%. The by-laws and the Articles of Incorporation can be amended at any regular meeting of the Board of Directors. The board members also have the rights to sell the facilities.

The members have no voting rights except for the following:

- a. Special assessments of the members;
- b. Approval of any increases in fees that exceed the 10% limit that the board can assess;

- c. Any change in the membership admission and provisions to the extent that such changes alter pre-existing memberships.

The right to approve must be by a majority vote.

LAW

IRC 501(c)(7) exempts from Federal income tax "Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder."

Application of Law

Revenue Ruling 66-225, 1966-2- CB 227 holds that a nonprofit organization which provides entertainment for its members does not qualify for exemption under section 501(c)(7) of the Internal Revenue Code of 1954 where it is controlled by a taxable corporation and operated as an integral part of such corporation's business. The club was formed and incorporated by the owners of the motel to operate a private club for its members and to provide entertainment, food, and refreshment for them. The clubhouse with all fixtures and equipment is leased by the organization from the motel for a nominal fee, but the motel retains the exclusive right to serve food and beverage to the club's members. Under the circumstances described above the motel owners organized the club to operate a cocktail lounge and cafe as an integral part of their motel and restaurant business. Therefore, the club is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes.

Revenue Ruling 65-219, 1965-2 CB 168 holds that a club which is operated under an agreement with its resident agent whereby he controls the size of the club membership, the amounts of initiation fees and annual dues, and retains all initiation fees and 90 percent of dues and transfer fees in return for the exclusive use of the swimming pool which he owns and operates is not exempt under section 501(c)(7) of the Code. In this instance, the club entered into a licence agreement with its resident agent, whereby the resident agent agreed to pay for the construction of an olympic-size pool for exclusive use, on a tract of land which he had leased. Under the terms of the agreement the licensor controls the size of the club membership, the amount of initiation fees, the amounts of annual fees and the amount of annual club dues, and transfer fees. The licensor reserved the right to operate a snack bar and other concessions on the pool property. The club agreed to pay the licensor all monies collected as initiation fees from members, 90 percent of all annual dues, and 90 percent of all transfer fees. The club receives no equity in the pool or other property although financed by members' initiation fees. Exemption was denied since the licensor has the power to control the amount of income by virtue of his control with respect to solicitation, number, and transfer of memberships as well as control over the amounts of initiation fees, transfer fees, and club dues.

[REDACTED]
[REDACTED]

In revenue ruling 74-489, 1974-2 C.B 169 a corporate member is a membership issued to a corporation, an artificial entity. The corporation designates which of its officers and employees may use the club's facilities. This type of membership is not within the contemplation of the statute, and a club having such membership is, in fact, dealing with the general public.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides, in part, that the exemption provided by section 501(a) of the Code for organizations described in section 501(c)(7) of the Code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earning inures to the benefit of any private shareholder.

Revenue ruling 58-589 states that a membership category that does not afford the members voting rights, and whose membership could be terminated at any time and who have no control over the operation and management of the club, is evidence that such membership merely has been conferred the right to use the facilities of the club upon payment of required fees and dues. It was concluded that the organization was engaged in the business of selling services.

TAXPAYER'S POSITION

The attorney states that the [REDACTED]'s participation as the common shareholder is not to provide an opportunity to take the applicant's revenue for its own purpose as in revenue ruling 65-219, but that [REDACTED] will supplement any deficits experienced by the applicant and therefore requires some control over the applicant. Also, unlike the for-profit organization described in the revenue ruling, the attorney alleges that [REDACTED] does not control the revenue flow of the applicant. He says that the members set the membership fees and own the facilities.

Sections 8.1 and 8.3 of the Bylaws indicate that it is the Board of Directors, selected by [REDACTED], who determines the initiation fees and monthly membership dues and not the true "members". These members are permitted to vote to increase member assessments but not establish the initiation fees and monthly membership dues. The applicant has entered an agreement to pay [REDACTED] for its costs of constructing the facilities, but the facilities belong to [REDACTED], the owner of the property. It does not appear necessary for [REDACTED] to remain in the shadows to loan money in the event the applicant incurs a deficit. The applicant is like the organization in Revenue Ruling 65-219 because the persons identified as the board of directors are actually the agents of the for-profit corporation and individual members. Although the owner of the common stock is called a member, it in fact is not a member for purposes of section 501(c)(7).

With regards to Revenue ruling 69-281, the attorney states that the applicant is similar to the organization in that revenue ruling because the applicant is not operated by the developer of a commercial venture

[REDACTED]

for the developer benefit. He argues that the applicant is operated for the pleasure of its members. However, in that revenue ruling all member have equal voting rights. The club is managed and controlled by a board of directors elected from and by the members. The sole voting member of the applicant, TGDC, selects the board of directors who have all of the decision making powers.

SERVICE POSITION

The facts that the "members" have no voting rights as to the selection of the directors, the establishment of initiation fee and dues, the approval of members and no authority to terminate the lease agreement, no authority to terminate the management agreement, and no authority to dissolve the corporation or to sell any assets, support the conclusion that the organization is not organized and operated for the pleasure and enjoyment of its members. The [REDACTED] to [REDACTED] members of the applicant do not control it.

Based on the information given, the Board of Directors establishes the one time initiation fee, the monthly dues amounts, increases up to [REDACTED]%, the number of members, and how the club will be managed. They also have the power to enter into a land lease agreement with [REDACTED], an affiliate [REDACTED] and the power to buy the facilities from [REDACTED] for \$[REDACTED] million.

The members have no voting rights except for (1) special assessments for members, (2) approval of any increases in fees that exceed the 10% limit, (3) any change in the membership admission and provisions to the extent that such changes alter pre-existing memberships.

Your by-laws state that the directors are elected by the shareholders who are entitled to vote. The holders of the common stock are the only ones who are allowed to vote, and the common stock is only issued to [REDACTED] or its affiliates. The facts indicate that the applicant is controlled and organized by a for profit organization, which is similar to the organization that was denied exemption in Revenue 65-219.

In this arrangement, the revenue that is generated by the country club will flow back to the for profit organization. [REDACTED] control the amount of income by establishing the initiation amounts and fees. They will also receive [REDACTED]% of gross revenues (which includes all sales of products, merchandise, food and beverage items, fees, membership dues, and all other receipts which are treated as income under the generally accepted accounting principals) as set forth in the management contract. The members have no voice in determining who they would like to manage their facility or the terms of the contract. In addition, they have no voice in regard to buying the facilities or the terms of the Land Lease agreement with [REDACTED].

[REDACTED]
[REDACTED]

The applicant's income is inuring to the benefit of the for-profit company, [REDACTED]. According to the attorney in his [REDACTED] letter, the applicant has paid [REDACTED] for its construction and related costs in building and erecting the golf course, clubhouse, swimming pool, health facilities, etc. on property owned by [REDACTED]. Any improvements made or facilities, building, and permanent structures erected on the real estate become property of [REDACTED] as owner of the property. Furthermore, the construction has increased the value of the real estate. [REDACTED] has incurred a debt of \$[REDACTED] million to [REDACTED] for construction of facilities it does not own; [REDACTED] owns the construction since it is located on its real property.

Upon dissolution of the applicant, preferred stock members are only entitled to receive up to the amount of the initiation fees paid plus dues on a pro rata basis. They are not entitled to any remaining assets which exceed the amount of their payments per Article 7.2 of the bylaws. Furthermore, the board of directors hold the right to terminate all memberships at any time.

Conclusion

The organization activities further the business interest of its officers and their respective for-profit corporations. The management and lease agreements between the applicant and [REDACTED] and the applicant and [REDACTED] do not constitute arm's length transactions. The president of the applicant is also president of [REDACTED] and [REDACTED]. The two for-profit corporations control the applicant.

Like organizations described in Revenue Ruling 65-219 and 66-225, your organization is operated as a commercial venture for the financial benefit of a for profit organization and is not exempt under section 501(c)(7) of the Code.